CEQUEL ENERGY INC.

THIS TEAM WORKS

ANNUAL REPORT 2002

The Annual Shareholders' Meeting will be held on Monday, June 9, 2003 at 3:00 p.m. in the McMurray Room, Calgary Petroleum Club, 319 - 5 Avenue S.W., Calgary, Alberta. Those shareholders unable to attend are encouraged to complete and return the form of proxy mailed with this Annual Report.

This Team Works

This Team Delivers

Corporate Profile

» In late 2001, the former management of Cypress Energy Inc. reunited to find and acquire a new company with which to repeat the success they had achieved with Cypress. In January 2002 this group invested in the reorganization of Argonauts Group Ltd.

Following this transaction, the former Cypress team replaced Argonauts' management, board and staff. The new management team recapitalized Argonauts through a transaction that included a large injection of their own funds, re-evaluated the Company's existing assets, and proceeded to launch an acquisition program focused on acquiring select properties, infrastructure and undeveloped land. In April, they changed the Company's name to Cequel Energy Inc. to reflect the transformation of the company.

The 2002 annual report has been designed as two separate books. The first, *This Team Works,* provides insight on the major transactions completed during the year, the impact on operations, and the strategy going forward. The second, *This Team Delivers,* provides a review of the statutory financial information.

President's Message

The Oxford dictionary provides six definitions of the word "sequel". They include 1. A body of followers; 2. Descendents; 3. A thing that follows as a result of an event or course of action; 4. What happened or will happen afterwards; 5. The ensuing or remaining part of a narrative that, although complete in itself takes up and develops the story; 6. A number of things in succession.

All of these definitions describe some characteristic of our new company, Cequel Energy Inc. This company represents the partnering of a group of former employees of Cypress Energy. As one of these "body of followers" I believe we have brought to Cequel a similar strategy, direction and focus as the principles that proved to be successful at generating consistent growth for Cypress. It is our intention to continue this story, creating another successful energy company.

As a predecessor company, Cypress left an enviable track record. The company was launched in March 1996 with equity of $6 million from the initial public offering. Between 1996 and 2001, production increased every quarter for five years, from zero to about 20,000 barrels of oil equivalent per day and the stock price went from $0.20 to $14. The Cequel story is following that pattern. Our initial acquisition of Argonauts Group Ltd. was financed by an investor-group comprised of the former Cypress management team, who invested in units comprised of $8 million in equity and $9.5 million in warrants. With 24 percent of the common equity on a fully diluted basis, our team is involved and committed. As our annual report cover states, this is a team that works, in every sense.

Our team has had only a year to apply our strategy within this new corporate entity, but the results have been significant. Production in 2002 increased from 1,300 boe per day to 8,300 boe per day. Monthly cash flow per share grew from less than $0.01 to $0.10 and our equity price increased from $1.20 to $5.50. While this kind of incremental growth is usually only generated from a start up position, I am confident our future growth rate will continue to be very strong. We have entered 2003 with a strong balance sheet and an enviable land position. Cequel has close to 300,000 net acres of undeveloped land. Our capital expenditure budget of $50 – 60 million, net of acquisitions, will be allocated primarily to drillbit activities – land acquisition, seismic and drilling. Our existing production infrastructure is extensive and underutilized, allowing us to add production for minimal cost. And, in an environment that is increasingly bullish on natural gas, we are well positioned from a commodity standpoint with 75 percent of our production being natural gas, not including natural gas liquids. We are very confident that we will meet or exceed our target of 9,300 boe per day of production in 2003 through the exploitation of our existing asset base.

We have accomplished a lot in only one year but in many ways we have the benefit of a proven formula to guide our decision-making. This team will apply what worked well at Cypress and avoid the things that were not as successful. In that context, I believe we can provide a roadmap for our investors by outlining the lessons we have learned. Some of these strategies have already been applied at Cequel; others will direct our future activities.

1

Deliver value through the drillbit; through asset acquisitions and through corporate acquisitions.

For an energy company to grow through all phases of the commodity price cycle, we believe it is critical to be able to add reserves through a cost effective exploration/exploitation program as well as through corporate and asset acquisitions. This three-part strategy allows us to execute cost effective acquisitions when commodity prices are low and asset values are attractive. When the cycle reverses and commodity prices increase, we are able to deliver continued growth through exploitation of our asset base. Our prior success was built upon all three approaches; successful drilling, successful property acquisitions, and the completion of eight corporate takeovers. We have executed on all three parts of this strategy at Cequel as well. During 2002 we acquired Chain Energy for $36 million, adding 1,400 boe per day. In addition we completed two significant property acquisitions from EnCana and Devon valued at $108.5 million, adding over 4,500 boe per day. This deliberate and aggressive acquisition program allowed us to establish a base of assets quickly while the commodity price cycle was attractive. We made this an effective acquisition by assimilating the properties and operations very quickly. By the third quarter of 2002 we were drilling and recompleting wells on our newly acquired properties. As we move into 2003 we will continue to exploit these assets while looking at opportunities for acquisitions that provide attractive economics.

2

Maintain a financial structure that is flexible and conservative.

Acquisitions are opportunity driven and come in varying sizes. Capturing the opportunity requires financial flexibility and a conservative balance sheet. Our acquisition program in 2002 was financed through bank debt and $112.3 million of new equity. At year end our debt to equity ratio was 0.35:1. This strong balance sheet combined with the cash flow provided by our ramped up production gives us the financial horsepower to pursue an aggressive capital program, including further acquisitions.

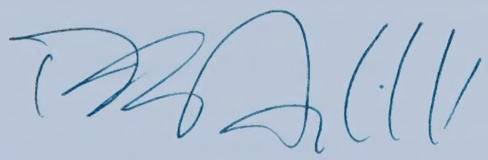
3 *Maximize revenue per boe; minimize costs per boe. In the resources industry the low cost producer ultimately wins.*

This two-part strategy influences many of the decisions on where and how Cequel operates. We are focused on liquids rich, high BTU natural gas; this bias proved very successful for Cypress and the same economic factors exist today. Demand for natural gas continues to increase, with demand exceeding current supply capabilities as reflected in long-term commodity price forecasts. Natural gas with a high liquids content will typically attract prices that reflect a premium over AECO pricing.

Minimizing costs is a function of a number of factors. One is developing a focused approach to core areas of operation, which promotes a concentration of activity that reduces costs in many ways. Cequel's operating areas are highly focused in the Peace River Arch, Gold Creek/Karr regions of northwestern Alberta and in Central Alberta. The benefits of this concentration are reflected in the increased geological understanding that allows us to rapidly exploit these areas; and our ownership of the infrastructure that allows us to bring production rapidly on stream. This approach allows us to reduce both finding and development costs and operating costs. The other important cost factor is general and administrative costs which we control through our compensation approach. Because our employees are also shareholders, we have tied our compensation such that it links the performance of our people to the performance of our company. In effect, our employees are motivated by the same factors as our shareholders, and we feel this alignment is beneficial to both.

Cequel would not be where it is without the support of the entire team of people that make this happen every day. We have accomplished so much in a short period of time and I want to thank all of you for your contributions. I also am very grateful to our Board of Directors for their support and direction throughout this first year of growth. I want to thank our shareholders for their trust and investment in this team and our decisions. I am confident that the work we have done this year has built a foundation for growth into the future.

On behalf of the Board of Directors,



Donald F. Archibald, *President and Chief Executive Officer*

Management Team

« *Donald F. Archibald*
President and Chief Executive Officer

Randal Brockway »
Vice President, Finance and Chief Financial Officer

« *Howard Crone*
Vice President, Operations and Chief Operating Officer

Alison Jones »
Vice President, Exploration

« *Gary Peddle*
Vice President, Land

Employees

» The Company's 37 employees have come together at Cequel Energy to repeat the success achieved at other successful oil and natural gas companies over the past ten years. Together, they work at developing value for all shareholders through strategic acquisitions and focused development. The theme of this year's annual report – *This Team Works* – truly embodies the energy and philosophy of the company. We would like to thank our employees for their dedication and commitment to Cequel…

Wendi Abercrombie
Marion Allan
Tanja Ambrozic
Don Archibald
Hany Beshry
Robin Bieraugle
Troy Bohn
Doug Bownes
Trevor Boyce
Randy Brockway
Brendan Carrigy
Jocelyn Christensen
Patsy Corning
Howie Crone
Daemond Dummer
Barbara Farrell
Tammy Farmer
Darren Feddema
Nicola Franks
Fred Gallani
Greg Gonis
Michelle Holt
Alison Jones
Mike Kabanuk
Bob Laidler
Cheryl Leitch
Wes Ludwig
Charles Mazereew
Tyson Miller
Gary Peddle
Indy Raychaudhuri
Garry Schau
Richard Thompson
Erin Thorson
Jill Tuggle
Jerrold Yip
Darren Young

Review of Operations

Cequel has a well-defined operating strategy that has guided our decisions throughout 2002 and will continue to govern our operating strategy for 2003 and beyond. This strategy has three elements: we will concentrate land and production within core areas where we can focus our knowledge and efforts; we will strive to operate all our programs in order to manage timing and minimize costs; and we will seek control of our infrastructure to reduce our costs and control timing. From a geological and geographic standpoint, our focus is on natural gas in the western Canadian sedimentary basin. We have focused our acquisitions on properties offering medium depth, medium risk, multi-zone potential which are prolific, economic and relatively abundant in the belt that runs from central to northern Alberta, north/south along the foothills. Cequel currently has properties in three core areas that demonstrate these characteristics and over 275,000 acres of net undeveloped land. These three core areas – Northwest Alberta, Central Alberta and the Peace River Arch – account for close to 90 percent of our production.

Central Alberta

Our interests in Central Alberta provided 13.6 percent of production and represented 11.7 percent of total established reserves at year-end 2002. Properties include Thorsby, Gilby/Westerose and other minor properties, all of which can be characterized as medium depth, multi-zone, natural gas prone properties with established processing infrastructure. The Thorsby area was the major producing area for Cypress Energy and we have substantial understanding of the area. Our view is that Central Alberta is relatively mature and will not require significant investment in the future.

Peace River Arch

Cequel acquired the Peace River Arch properties through our acquisition of Chain Energy in March 2002. The principle property is Pouce Coupe/Gordondale which is a medium depth, natural gas prone property with multi-zone potential, primarily from the Doig and Halfway formations. While Cequel does not own or control facilities in the area, three facilities in the area are accessible and have processing capacity. At year end, this area was generating six percent of production and two percent of established reserves. Cequel has extensive 3D seismic coverage of the area and in 2003 we plan to drill up to six wells with an average working interest of 45 percent. We also intend to expand our land base of around 15,000 net undeveloped acres in 2003.

Gold Creek / Karr / Economy Creek

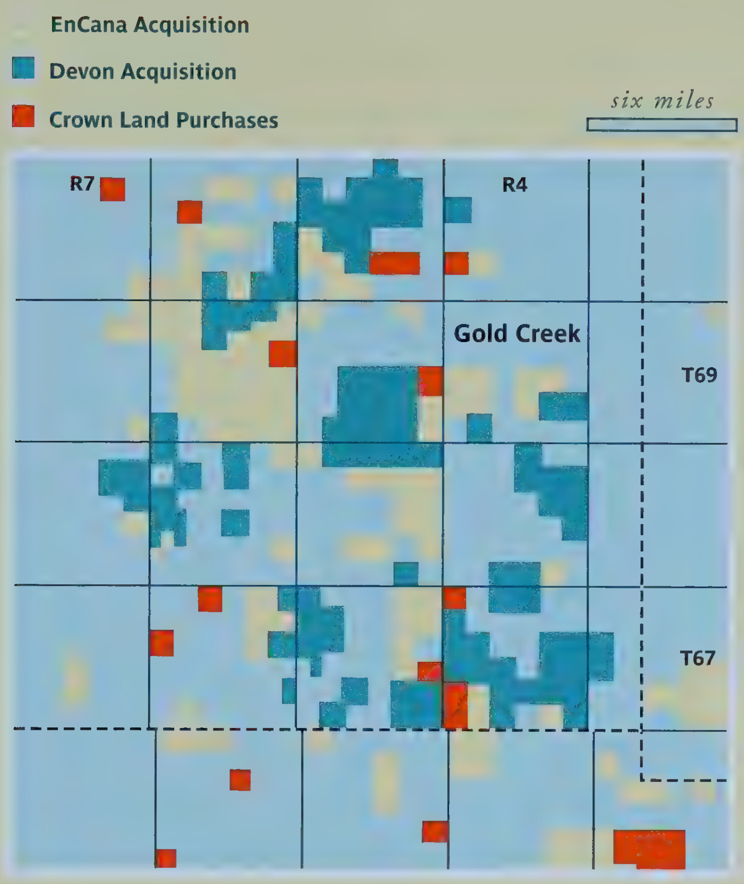
Cequel's properties in this area were acquired in two transactions completed in June and August 2002 for a total cost of $108.5 million. The area consists of three distinct properties – Gold Creek, Karr and Economy Creek – which, at year end were generating 67 percent of our production and represented 77 percent of total established reserves. Cequel was attracted to this area as it met our criteria of a medium depth, multi-zone, natural gas prone property with year round access, established processing

infrastructure and a significant amount of undeveloped land located in a desirable part of the Western Canadian Sedimentary Basin. Not only did we see unrealized exploitation drilling potential for this area, we also acquired with the transaction an interest in two 100 mmcf per day natural gas processing facilities that are significantly underutilized. We could clearly see the potential for lower risk drilling combined with cost effective tie in of production from this area.

Our initial strategy for this area during 2002 was to tie in existing wells, undertake recompletions and workovers of wells and initiate an exploitation drilling program. During 2002 we drilled 12 gross wells in this area with 100 percent success. We tied in 13 gross wells and executed successful workovers and recompletions on 22 gross wells. We also acquired additional land in the area. Our ownership of infrastructure also delivered results as we were able to produce wells through existing plants, reducing operating costs from approximately $8 per boe to $4 per boe in 2002. This trend will continue with ongoing success from the drilling program.

In 2003, we plan to execute a similar program of drilling, workovers and completions involving up to 50 – 60 wells. Average wells in this area range in depth from 1200 to 2500 metres and cost from $250,000 to $850,000 to drill. Typically wells intersect at least two zones and deliver production averaging around 1.0 mmcf per day and reserves of close to 1.0 bcf. The area provides enormous diversity of risk as there are nine distinct producing horizons at medium depths and many separate pools. Over time, we intend to expand our drilling program to target producing horizons at deeper depths.

Gold Creek



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Gold Creek

Property Characteristics

- Medium depth
- Multi-zone
- Liquids rich sweet natural gas
- Year round access

December 2002 Average Production

- 23 mmcf/d of natural gas
- 867 bbls/d of crude oil and NGLs
- 56% of December 2002 average production

Reserves

- 15 mmboe established
- 78% proven
- 83% natural gas
- 17% oil and liquids
- 62% of Cequel's total 2002 established reserves

Facilities

- Operated infrastructure
- 27% interest in the Gold Creek 100 mmcf/d natural gas plant

Net Undeveloped Land Holdings (Gold Creek/Karr)

- 159,405 net undeveloped acres
- 71% average working interest

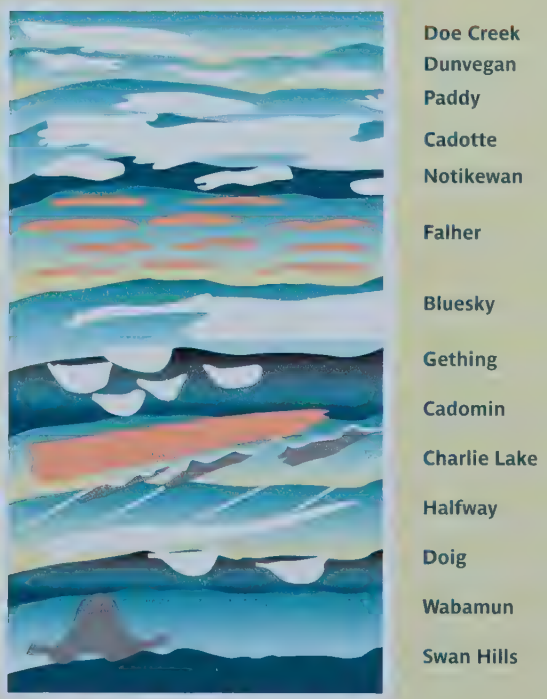
2002 Highlights

- Drilled 10 gross (8.6 net) wells at 100% success rate with eight gross wells classified as exploration wells
- Completed workovers/recompletions on 18 gross (15.1 net) wells
- Tied in 11 gross (11 net) wells

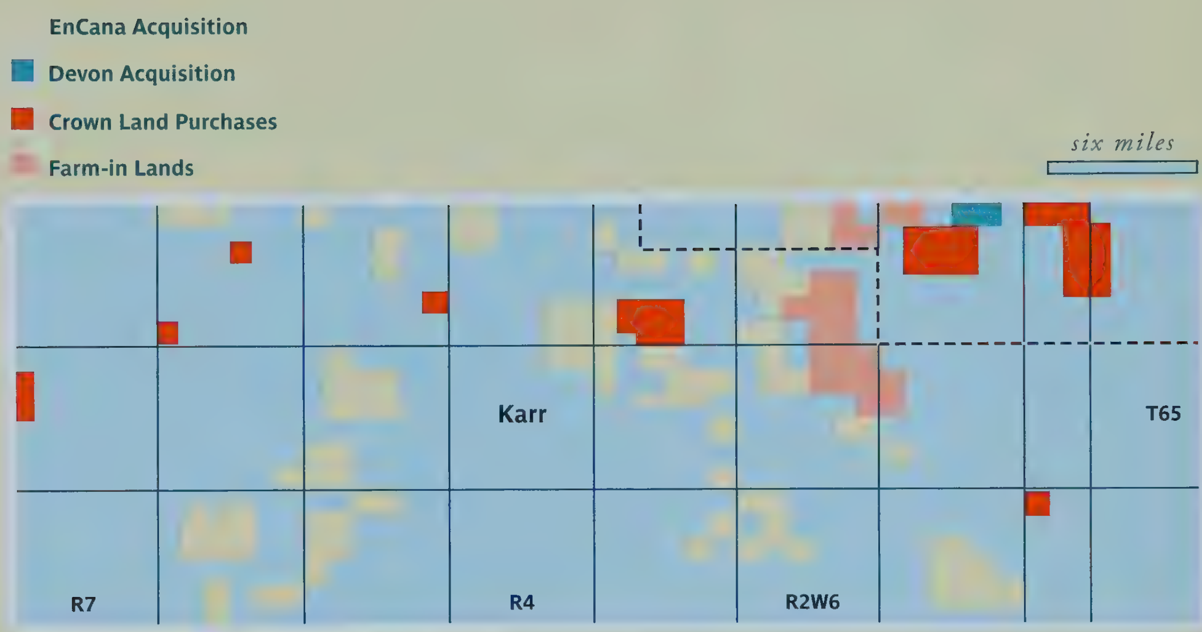
2003 Plans

- Drill 20 – 25 new wells and 15 – 20 workovers/recompletions
- Acquire additional undeveloped land

Cross Section: Gold Creek / Karr / Economy Creek



Karr



» Karr

Property Characteristics

- Medium depth
- Multi-zone
- Liquids rich sweet natural gas
- Year round access

December 2002 Average Production

- 3 mmcf/d of natural gas
- 368 bbls/d of crude oil and NGLs
- 10% of December 2002 average production

Reserves

- 3 mmboe established
- 81% proven
- 68% natural gas
- 32% oil and liquids
- 12% of Cequel's total 2002 established reserves

Facilities

- Operated infrastructure
- 12% interest in the Karr 100 mmcf/d natural gas plant

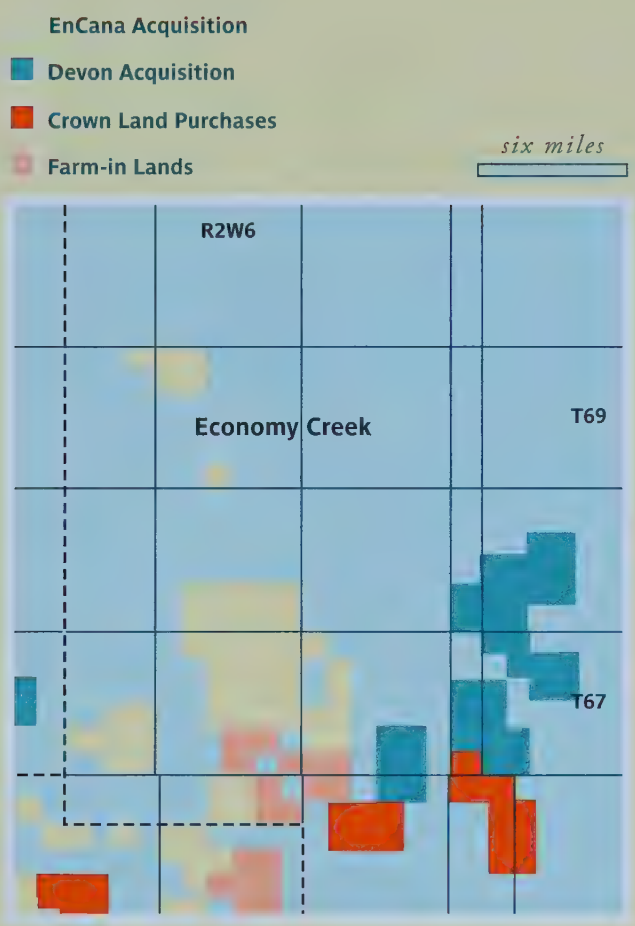
2002 Highlights

- Drilled two gross (1.75 net) wells at 100% success rate with both classified as exploration wells
- Completed four gross (3.6 net) workovers/recompletions
- Tied in two gross (2 net) wells

2003 Plans

- Drill 10 – 15 new wells and 5 – 10 workovers/recompletions
- Acquire additional undeveloped land

Economy Creek



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Economy Creek

Property Characteristics

- Medium depth
- Multi-zone
- Liquids rich sweet natural gas

2002 Highlights

- Completed a 24 section farm-in with three companies and two acquisitions in early 2003 that significantly expanded our land position
- Successfully drilled and cased our first two exploration wells
- Acquired three suspended wells

2003/2004 Plans

- Further review our excellent seismic, which covers the majority of the land
- Turn the focus to a growth area in late 2003 to 2004. This area, just off the edge of the Deep Basin, has been relatively unexplored
- Tie in production from Economy Creek to the Karr natural gas processing facility, potentially in early 2004

Marketing

» During 2002, Cequel did not engage in any hedging activity for either natural gas or oil. It is not expected that the Company will engage in any hedging activity in 2003.

For the 17 month period ended December 31, 2002, Cequel received an average sales price of $34.28 per bbl for oil, $4.62 per mcf for natural gas and $29.83 per bbl for NGL's.

Cequel assumed one fixed price natural gas sales obligation for $3.75 per gigajoule (GJ) which required the Company to deliver a baseload quantity of natural gas of up to 5,000 GJ's per day. This arrangement expired November 1, 2002.

In 2003, in addition to the fixed price contract, Cequel assumed various natural gas aggregator contracts relating to the Company's EnCana and Devon property acquisitions, which both closed in the summer of 2002. The total volume for these contracts equal 8.5 mmcf per day at December 31, 2002. •

Corporate Governance

» Cequel's Board of Directors is responsible for establishing the company's general strategic direction and overseeing management's conduct of the business. The Board of Directors is also responsible for identifying and managing the principal business risks of Cequel, assessing senior management, succession planning, developing Cequel's approach to corporate governance issues, developing communication policy and assessing the adequacy of internal control and management information systems. The Board at large assesses its functions independent of management and determines its composition, size and effectiveness. In light of the size of the Board, no formal position descriptions for the Board have been developed. Any board member is authorized to engage outside advisors at the expense of Cequel if considered necessary.

Consistent with Cequel's streamlined approach to management, the Board consists of five individuals: the President and Chief Executive Officer of Cequel and four unrelated directors. All of the directors own common shares and have options to purchase common shares.

The Board has established three committees. The Audit Committee reviews the annual financial statements and meets with the external independent auditors to review and consider audit procedures and to assess the appropriateness and effectiveness of Cequel's policies, business practices, internal controls and management information systems. The members of the Audit Committee have direct access to the external auditors. The Audit Committee also reviews the quarterly financial statements and management's discussion and analysis of financial results. The Compensation Committee reviews executive compensation matters, including key human resources policies, the remuneration policy, the compensation and performance objectives of the executives including bonuses. The Reserves Committee reviews the selection of the company's independent engineers, as well as the reserves estimates and evaluations prepared by these engineers. The committee also reviews the methodologies used by the independent engineers and ensures the reliability of the information provided. •

Board of Directors

Donald F. Archibald

Mr. Archibald has been the President and Chief Executive Officer of Cequel since January 24, 2002; prior thereto Mr. Archibald was the President and Chief Executive Officer of Cypress Energy Inc., a public oil and natural gas company, from 1995 to March 2001.

Fred C. Coles

Mr. Coles recently retired as the Executive Chairman and Chairman of the Board of Applied Terravision Systems Inc., a position he held since 1986. Mr. Coles serves on the Audit and Reserves Committees.

Geoffrey A. Cumming

Mr. Cumming has been the Vice Chairman and Chief Executive Officer of Gardiner Group Capital Limited and Garbell Holdings Limited, private Canadian investment companies, since October, 1994. Mr. Cumming serves on the Compensation Committee.

Douglas A. Dafoe

Mr. Dafoe has been the President and Chief Executive of Thunder Energy Inc., a public oil and natural gas company, since October, 1995. Mr. Dafoe serves on the Audit, Reserves and Compensation Committees.

Max Muselius

Mr. Muselius has been a rancher in Southern Alberta and British Columbia since January, 2000; prior thereto he was the Executive Chairman of Ensite Incorporated from January, 1999 to December, 1999. From 1996-1999, Mr. Muselius was a business consultant. At Renaissance Energy, he was Vice President from 1986. Mr. Muselius serves on the Audit and Compensation Committees.

Interim Period Information Summary

Interim Period Ending		Dec. 31 2002	Sep. 30 2002	Jun. 30 2002*	Apr. 30 2002	Jan. 31 2002	Oct. 31 2001
FINANCIAL (unaudited) *($ 000's, except per share amounts)*							
Petroleum and natural gas sales		25,385	14,542	4,067	4,376	3,195	4,099
Cash flow from operations		16,024	7,813	2,038	1,710	(2,450)	1,853
Per share – basic		0.278	0.142	0.055	0.051	(0.143)	0.112
Per share – diluted		0.248	0.126	0.047	0.043	(0.143)	0.104
Net income (loss)		5,905	884	432	(185)	(2,311)	495
Per share – basic		0.102	0.016	0.012	(0.006)	(0.135)	0.030
Per share – diluted		0.091	0.014	0.010	(0.006)	(0.135)	0.028
Capital expenditures, net		16,703	34,412	79,850	47,078	824	1,382
Working capital (deficit)		(8,168)	(2,500)	(5,406)	(4,704)	(2,241)	(3,120)
Bank debt		37,000	41,871	26,647	11,648	nil	4,100
Shareholders' equity		127,790	121,917	106,446	42,579	19,040	13,098
COMMON SHARE INFORMATION *(000's, except common share price)*							
Weighted average shares outstanding		57,726	55,161	37,203	33,461	17,135	16,537
Fully diluted shares outstanding		64,739	61,828	43,784	39,620	17,135	17,895
Common share price ($)							
High		5.61	4.80	4.60	4.05	2.99	2.09
Low		3.80	3.20	3.20	2.55	0.95	1.20
Close		5.50	4.50	3.85	3.35	2.80	1.39
PRODUCTION							
Crude oil	bbls/d	1,343	1,188	725	646	740	831
NGLs	bbls/d	762	568	255	166	97	105
Natural gas	mcf/d	32,913	25,406	9,084	5,239	4,191	4,022
Barrels of oil equivalent (6:1)	boe/d	7,591	5,990	2,494	1,685	1,536	1,606
AVERAGE REALIZED PRICES							
Crude oil	$/bbl	36.94	39.76	35.53	33.76	23.40	31.50
NGLs	$/bbl	34.86	28.59	24.87	24.27	19.62	25.89
Natural gas	$/mcf	5.91	3.63	3.64	4.54	3.33	3.33
Barrels of oil equivalent (6:1)	$/boe	35.65	25.99	26.14	29.44	21.60	26.33

Interim Period Ending	Dec. 31 2002	Sep. 30 2002	Jun. 30 2002*	Apr. 30 2002	Jan. 31 2002	Oct. 31 2001
NETBACK SUMMARY						
($ per boe)						
Revenue						
Sales price	35.65	25.99	26.14	29.44	21.60	26.33
Royalty income	0.70	0.39	0.59	(0.26)	1.00	1.41
	36.35	26.38	26.73	29.18	22.60	27.74
Expenses						
Royalties	(7.44)	(6.14)	(3.94)	(6.87)	(5.88)	(5.97)
Production expenses	(3.96)	(4.93)	(5.99)	(7.10)	(7.90)	(5.03)
Operating cash flow	24.95	15.31	16.80	15.21	8.82	16.74
General and administrative	(1.35)	(1.00)	(3.10)	(3.54)	(6.49)	(3.79)
Reorganization expense	–	–	–	–	(18.72)	–
Interest	(0.55)	(0.61)	0.12	(0.17)	(0.85)	(0.42)
Current income and capital taxes	(0.10)	0.48	(0.42)	(0.10)	(0.10)	–
Cash flow	22.95	14.18	13.40	11.40	(17.34)	12.53
Depletion, depreciation and amortization	(8.82)	(9.63)	(9.77)	(13.03)	(8.66)	(7.43)
Future income taxes	(5.67)	(2.95)	(0.79)	0.39	9.64	(1.76)
Net income	8.46	1.60	2.84	(1.24)	(16.36)	3.34

** Note the interim period ending June 30, 2002 is a two month period.*

Corporate Information

Officers

Donald F. Archibald
President
and Chief Executive Officer

Randal Brockway
Vice President, Finance
and Chief Financial Officer

Howard Crone
Vice President, Operations
and Chief Operating Officer

Alison Jones
Vice President, Exploration

Gary Peddle
Vice President, Land

Directors

Donald F. Archibald
President and Chief Executive Officer
Cequel Energy Inc.

Fred C. Coles
President and Chief Executive Officer
Menehune Resources Ltd.

Douglas A. Dafoe
President and Chief Executive Officer
Thunder Energy Inc.

Max Muselius
Independent Businessman

Geoffrey A. Cumming
Vice Chairman and Chief Executive Officer
Gardiner Group Capital Limited

Bankers

Bank of Montreal
Calgary, Alberta

Auditors

Deloitte & Touche LLP
Calgary, Alberta

Evaluation Engineers

Gilbert Lausten Jung
Associates Ltd.
Calgary, Alberta

Legal Counsel

Macleod Dixon
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Calgary, Alberta

Trading Information

Corporate Head Office

Cequel Energy Inc.
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Calgary, Alberta T2P 2V6
Tel: (403) 262-9609
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Investor Relations Information

www.cequelenergy.com
Stock Listing Symbol:

"CQL"

The Toronto Stock Exchange

Designed and Produced by Result Inc.
Printed in Canada

Cequel... energy inc.

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Fax: (403) 262-0055

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THIS TEAM DELIVERS

ANNUAL REPORT 2002

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This Team Works

This Team Delivers

Management's Discussion & Analysis

This discussion and analysis should be read in conjunction with the accompanying financial statements along with the related notes thereto for the seventeen month period ended December 31, 2002. Per barrel of oil equivalent ("boe") amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil ("6:1"). The reader should be aware that historical results are not necessarily indicative of future performance.

This management's discussion and analysis ("MD&A") contains forward-looking statements. Forward looking statements are based on current expectations that involve a number of risks and uncertainties which could cause actual events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of Cequel's management at the time the statements were made. Cequel assumes no obligation to update forward-looking statements should circumstances or management's estimates change.

GENERAL

The current seventeen month period marked a period of transition for Cequel. A management reorganization was undertaken in January 2002 whereby all the then current directors and officers of Cequel resigned and were replaced with a new slate of directors and new management team. The new management team, with the approval of the board of directors, implemented a more aggressive growth strategy for Cequel.

As management and directors, we believe that a successful oil and natural gas company must not only be able to deliver value and growth through drilling but it must also be able to make prudent property and corporate acquisitions. At any time in the oil and natural gas business cycle, one particular growth strategy may be more effective than another, therefore, a company should be able to deliver growth and value through a strategy of drilling and/or acquisitions.

We also believe that an oil and natural gas company should maintain a financial structure that is both flexible and conservative. Commodity prices are very volatile and a conservative balance sheet should be maintained to prosper through the ups and downs of the commodity price cycle. In addition, acquisitions tend to be opportunity driven and the ability to act on these opportunities as they arise generally requires financial flexibility and a conservative balance sheet.

We also endeavor to maximize our revenue and minimize our costs in order to maintain consistently high operating margins. This strategy can be achieved through various means including targeting specific types of commodities such as liquids rich, high energy content natural gas, concentrating activities in focused areas and maximizing ownership of infrastructure.

The growth strategy implemented by the new management team and board of directors saw Cequel close the acquisition of Chain Energy Corporation ("Chain") effective March 31, 2002. In addition, Cequel closed two major property acquisitions. The first acquisition was effective June 30, 2002 at a cost of $75,800,000 before adjustments, and the second was effective August 30, 2002 at a cost of $32,500,000 before adjustments. A more active drilling program was initiated in the last few months of the current period in order to exploit the corporate and property acquisitions that were closed in the period. This active drilling program is expected to carry on throughout 2003.

The year-end of Cequel was also changed to December 31, 2002 in order to enhance the comparability of Cequel's results with other oil and industry participants. The year-end change resulted in an unusual seventeen month reporting period ending December 31, 2002, however, future reporting periods will be based on the more traditional calendar year.

The financial and operating results of 2003 will more fully reflect the full impact of the transactions undertaken by the new management team in the prior period. We expect Cequel will experience significant growth and profitability in 2003 as a result of these transactions.

DETAILED FINANCIAL ANALYSIS

Change in Year-end

On July 4, 2002, Cequel filed a notice under National Policy Statement No. 51 stating Cequel's intention to change the ending date of its financial year to December 31 from July 31, commencing with the seventeen month period ending December 31, 2002. The reason for the change was to align the financial reporting periods of Cequel with the majority of public companies and thereby allow investors to better assess the performance of Cequel based on similar reporting periods. Accordingly, the current MD&A requires the comparison of seventeen month period ending December 31, 2002 to the twelve month period ending July 31, 2001. Statistics are shown on a per barrel or percentage basis whenever possible in order to facilitate the comparisons.

Petroleum and Natural Gas Sales

In the seventeen month period ended December 31, 2002, petroleum and natural gas sales increased to $55,664,000 as compared to $26,885,000 for the twelve month period ending July 31, 2001.

TABLE A — P&NG SALES

($000s)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Oil sales	16,425	10,847	51
Natural gas sales	33,025	14,129	134
Ngl sales	5,109	2,018	153
	54,559	26,994	102
Royalty income	1,105	(109)	nm
Total PNG sales	55,664	26,885	107

The increase in petroleum and natural gas sales experienced by Cequel in the seventeen month period ended December 31, 2002 as compared to the twelve month period ended July 31, 2001 is primarily a result of an increase in the average production volumes in the current period combined with the longer seventeen month reporting period as compared to the twelve month comparative period.

The prices received by Cequel for the sale of its petroleum and natural gas in the current seventeen month period were considerably lower than those received in the comparative twelve month period.

TABLE B — AVERAGE SALES PRICE

(6:1 conversion)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Oil ($/bbl)	$ 34.28	$ 38.88	(12)
Natural gas ($/mcf)	4.62	8.47	(45)
Ngl ($/bbl)	29.83	42.67	(30)
Total ($/boe)	29.64	44.68	(34)

During the twelve month period ended July 31, 2001 the petroleum and natural gas industry experienced record commodity prices that did not last into the seventeen month period ended December 31, 2002. These record commodity prices were particularly evident in natural gas prices.

For the seventeen months ended December 31, 2002, Cequel received an average sales price of $34.28/bbl for oil, $4.62/mcf for natural gas and $29.83/bbl for ngls as compared to $38.88/bbl for oil, $8.47/mcf for natural gas and $42.67/bbl for ngls in the July 2001 twelve month period. The prices received in the seventeen month period in 2002 represent a decrease in price of 12% for oil, 45% for natural gas and 30% for ngls over the prices received in the July 31, 2001 twelve month period.

Cequel assumed one fixed price natural gas sales obligation from the June 30, 2002 property purchase, otherwise, it did not hedge prices or have any fixed price contracts for either petroleum or natural gas in the seventeen month period ended December 31, 2002 or the twelve month period ended July 31, 2001. The fixed price obligation that Cequel assumed required the delivery of a baseload quantity of natural gas not to exceed 5,000 gigajoules (GJ) per day at a fixed price of $3.75 per GJ. This obligation expired on November 1, 2002.

In addition to the fixed price natural gas sales obligation, Cequel assumed various aggregator contracts for the sale of its natural gas with the two major property acquisitions that closed in June and August of 2002. These aggregator contracts are tied to natural gas production from specific wells and will result in Cequel receiving prices that may vary from AECO daily index pricing on these volumes. The volumes subject to the aggregator contracts at the current period end were approximately 8,500 mcf/d, however, this volume will vary with the production from the specific wells and properties subject to the aggregator contracts.

AVERAGE DAILY PRODUCTION — TABLE C

(6:1 conversion)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Oil (bbls/d)	925	764	21
Natural gas (mcf/d)	13,786	4,568	202
Ngl (bbls/d)	331	130	155
Total (boe/d)	3,553	1,655	115

Looking forward into Cequel's 2003 year we expect substantially higher petroleum and natural gas sales than what was recorded in the seventeen month period ended December 31, 2002. These higher sales are expected to be achieved primarily as a result of higher average production levels. We currently expect Cequel's production for the 2003 year to average 9,300 boe/d. The commodity prices in 2003 are expected to average slightly higher than they were in the seventeen month period ending December 31, 2002. Going into 2003, Cequel is receiving both high natural gas prices and oil prices, however, these prices are expected to moderate over the year if the uncertainty over the Middle East situation with Iraq is resolved and natural gas storage levels are rebuilt to more normal levels. Given that Cequel has not hedged or fixed any of its commodity prices at the current time, the prices received by Cequel will fluctuate along with the market prices for the various commodities.

Cequel's results in its 2003 year will also be affected by the fact that the 2003 year will reflect a more normal twelve month period as compared to the seventeen month period ended December 31, 2002.

Royalties

In the seventeen month period ended December 31, 2002, royalties increased 102% to $11,922,000 from $5,897,000 for the twelve month period ended July 31, 2001. In the current seventeen month period, Cequel reclassified freehold mineral taxes to crown royalties from production expenses, where they had been reported in the comparative periods. Freehold mineral taxes recorded in these comparative periods have been reclassified to conform to the current period presentation.

The increase in royalties in the seventeen month period ended December 31, 2002 is a result of the increase in petroleum and natural gas sales as compared to the respective twelve month period ended July 31, 2001.

TABLE D ROYALTIES

($000s)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Crown	9,089	2,236	306
Freehold, GORR	3,104	3,661	(15)
ARTC	(271)	–	nm
Total royalties	11,922	5,897	102

The overall average royalty rate for the seventeen month period ended December 31, 2002 as compared to that of the twelve month period ended July 31, 2001 remained constant. However, the composition of the royalties changed substantially. In the past, the majority of properties that Cequel owned were on freehold land where freehold royalties were paid. The Chain acquisition along with the two major property acquisitions and recent drilling opportunities have been primarily on crown land; therefore, the composition of the royalties that Cequel now pays is weighted more towards crown royalties. As a result, Cequel has experienced an increase in crown royalties as a percentage of sales and a decrease in freehold and GORR as a percentage of sales.

TABLE E AVERAGE ROYALTY RATE

(average % of sales)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Crown	16.7	8.3	101
Freehold, GORR	5.7	13.6	(58)
ARTC	(0.5)	–	nm
Total royalties	21.9	21.9	0

In 2003, we expect Cequel's total royalties paid to increase along with the expected increase in total petroleum and natural gas revenues. We expect the average royalty rate in 2003 to also increase due to somewhat higher average expected commodity prices and a higher proportion of the drilling in 2003 to be done on crown land, which generally has higher average royalty rates than freehold lands.

Production Expense

In the seventeen month period ended December 31, 2002, net production expense increased to $9,317,000 as compared to $3,851,000 for the twelve month comparative period in 2001. A 21% decrease in production expense to $5.06 per boe was experienced in the seventeen month period as compared to $6.38 in the comparative twelve month period. The improvement in per boe production expenses incurred in the current seventeen month period can be attributed primarily to the two major property acquisitions that occurred in the period. The properties acquired had a lower production cost structure on average than Cequel's prior existing properties.

In the current seventeen month period, Cequel reclassified overhead recoveries to production expense from general and administrative expense, where it had been reported in the comparative periods. Operating overhead recoveries recorded in these comparative periods have been reclassified to conform to the current period presentation.

PRODUCTION EXPENSE TABLE F

($000s, except per boe)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Production expense (gross)	11,275	5,050	123
Overhead recoveries	(847)	(490)	73
Processing income	(1,111)	(709)	57
Production expense (net)	9,317	3,851	142
Production expense per boe (net)	5.06	6.38	(21)

In 2003, we expect Cequel's total production expense to increase as a result of expected increases in production. However, it is expected that net production expense per boe will decrease somewhat in 2003 due to the impact of the lower production cost property acquisitions undertaken in 2002 affecting the entire year instead of only part of the year as they did in 2002. In addition, most of Cequel's expected drilling in 2003 will take place on land or surrounding areas where Cequel has access to or owns facilities. This general reduction trend in production expenses will be mitigated somewhat by higher expected fuel and electricity costs and an expected general inflationary increase in costs.

Operating Netback

A decrease in average operating netback to $18.70 per boe was realized in the current seventeen month period as compared to $28.36 per boe in the comparative twelve month period. The decrease in average operating netback in the seventeen month period can be attributed mainly to the large decrease in average commodity prices realized by Cequel in this period. The impact of the lower average commodity prices on operating netbacks was mitigated to some extent by lower production expenses incurred on a per boe basis in the seventeen month period.

TABLE G — OPERATING NETBACK

($/boe – 6:1 conversion)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Sales price	29.64	44.68	(34)
Royalty income	0.60	(0.18)	nm
	30.24	44.50	(32)
Royalties	(6.48)	(9.76)	(34)
Production expense	(5.06)	(6.38)	(21)
Operating netback	18.70	28.36	(34)

General and Administrative Expense

In the seventeen month period ended December 31, 2002 general and administrative expense increased 18% to $3,981,000 from $3,382,000 in the twelve month comparative period in 2001. On a per boe basis general and administrative costs decreased 61% to $2.16 per boe in the current period as compared to $5.59 per boe in the comparative period. The main reason for this large decrease on a per boe basis is that in 2002 Cequel underwent a management restructuring whereby by new management team was put in place. The new management team implemented a lower general and administrative cost structure and embarked on a higher production growth strategy. This strategy resulted in the general and administrative costs being spread over a larger production base thereby achieving lower general and administrative costs on a per boe basis.

TABLE H — G&A EXPENSE

($000s, except per boe)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
G&A expense (gross)	4,549	3,633	25
Overhead recoveries	(568)	(251)	126
G&A expense (net)	3,981	3,382	18
G&A expense per boe (net)	2.16	5.59	(61)

In 2003, we expect Cequel's general and administrative costs on a per boe basis to decrease even further due primarily to the expected increases in average production in 2003.

Reorganization Expense

On January 24, 2002, Cequel completed certain reorganization transactions that included the resignation of all the then current directors and officers of Cequel and the appointment of new officers and a new board of directors. The costs of the reorganization were $2,645,000. These costs consisted primarily of severance payments to the previous officers and directors of Cequel and have been expensed in the seventeen month period ending December 31, 2002 as reorganization expenses. There were no reorganization expenses incurred in the prior comparative periods and we do not expect to incur any reorganization expenses in 2003.

Interest Expense

In the seventeen month period ended December 31, 2002 interest expense increased by $634,000 to $1,128,000 from $494,000 in the twelve months ended July 31, 2001. The average debt balances were significantly higher in the current seventeen month period than in the comparative twelve month period and thereby resulted in higher interest charges. The increase in average debt balances was primarily the result of the assumption of debt related to the Chain acquisition and the two major property acquisitions undertaken by Cequel during 2002. The full impact of the higher average debt balances in 2002 was mitigated to some extent by lower interest rates experienced in the current period as compared to the comparative period.

In 2003, we expect an increase in interest expense due to a combination of both higher average debt balances and expected increases in interest rates.

Gain on Sale of Investments

During the prior twelve month period ending July 31, 2001, Cequel sold its investment in shares of a publicly traded oil and natural gas company for total consideration of $5,921,000 and recorded a gain of $2,153,000. Cequel currently does not own any shares as an investment.

Depletion, Depreciation and Site Restoration

Depletion, depreciation and site restoration expense ("DD&A") increased by $12,622,000 in the seventeen month period ended December 31, 2002 to $17,226,000 from $4,604,000 in the twelve month comparative period of 2001. In the current seventeen month period Cequel's DD&A rate was $9.36 per boe as compared to $7.62 per boe in the comparative twelve month period. The increase in this rate in the current period generally reflects the higher cost of the corporate and property acquisitions, on a per boe basis, undertaken by Cequel in the current period.

Over the next year Cequel's actual DD&A rate per boe will ultimately depend on its drilling success and ability to purchase properties and add proven reserves at a reasonable cost.

Income Taxes

During the seventeen months ended December 31, 2002, Cequel recorded earnings before taxes of $9,663,000 along with a net current income tax recovery of $99,000 and corresponding future income taxes of $4,542,000. The current tax recovery is comprised of a net recovery of previous years' income taxes of $408,000 offset by large corporations tax expense of $309,000. In January 2002, Cequel incurred a large loss due primarily to the reorganization expenses. Cequel subsequently amalgamated with Chain in March 2002 thereby triggering a year-end for income tax purposes. The income tax returns for this tax year-end were filed in the current seventeen month period and requested that the losses for income tax purposes of Cequel be carried back to recover income taxes paid in previous years. The net effect of this income tax filing was for current income tax recoveries of $408,000 to be recorded along with a corresponding increase in future income tax expense.

For the year ended July 31, 2001 Cequel recorded current income taxes of $685,000 and future income taxes of $2,815,000. In the July 31, 2001 year Cequel was taxable on a current basis.

In 2003 Cequel is expected to pay large corporations tax. Whether Cequel pays current income taxes in 2003 depends on a number of factors including commodity pricing, production levels, corporate expense levels and both the type and amount of capital expenditures incurred by Cequel during the year. However, given the current high commodity price levels it is expected that Cequel will record sufficient taxable income to require the payment of current income taxes.

Net Earnings

In the seventeen months ended December 31, 2002, Cequel recorded net earnings of $5,220,000 as compared to net earnings of $7,316,000 in the comparative period in 2001. The decrease in net earnings in the current seventeen month period as compared to the comparative twelve month period resulted primarily from significantly lower commodity prices being realized along with the incurrence of significant reorganization costs and higher depletion, depreciation and site restoration expenses.

Capital Expenditures

Cequel's total capital expenditures for the seventeen month period ended December 31, 2002 and the twelve months ended July 31, 2001 are summarized as follows:

TABLE I CAPITAL EXPENDITURES

($000s)	December 31 2002 (17 months)	July 31 2001 (12 months)	%
Land & property acquisitions	109,619	3,102	3,434
Geological & geophysical	1,934	1,141	69
Drilling & completions	19,792	8,043	146
Facilities & equipment	7,920	2,749	188
Other	360	119	204
Corporate acquisitions	43,579	–	nm
Total Capital Expenditures	183,204	15,154	1,109
Dispositions	(2,955)	–	nm
Net Capital Expenditures	180,249	15,154	1,089

On March 26, 2002, Cequel closed the acquisition of Chain Energy Corporation ("Chain") and recorded a total of $43,579,000 of additional property and equipment related to the purchase. Included in this amount is an adjustment for future income tax of $5,648,000.

On June 27, 2002, Cequel closed the acquisition of certain producing oil and natural gas properties located in Alberta for a purchase price of approximately $75,800,000, subject to price adjustments effective June 1, 2002.

On August 28, 2002, Cequel closed the acquisition of certain producing oil and natural gas properties located in Alberta for a purchase price of approximately $32,500,000, subject to price adjustments effective July 1, 2002.

We estimate that Cequel will spend approximately $50 – $60 million on capital expenditures in 2003. The bulk of the expenditures are expected to be spent on drilling, recompletions and equipment and facilities. However, if larger property or corporate acquisitions are available capital expenditures in 2003 could significantly exceed the preliminary estimate of $50 – $60 million. The actual capital expenditures in 2003 will depend on a number of factors including available cash flow and other sources of financing, drilling opportunities and success and availability of potential property and/or corporate acquisitions.

Liquidity and Capital Resources

At December 31, 2002 Cequel had cash of $759,000, a working capital deficiency of $8,927,000, excluding cash, and a revolving demand loan of $37,000,000, which has been classified as current in accordance with the new CICA Emerging Issues Committee guidance.

During the current seventeen month period Cequel closed four private placement issues of various equity instruments as outlined in the table below.

EQUITY ISSUES TABLE J

	Date of Issue	Price per Share of Issue	Shares Issued	Gross Proceeds (000's)
Common shares	January 24, 2002	$1.05	7,619,047	$ 8,000
Common shares	February 12, 2002	$2.20	7,727,273	17,000
Subscription receipts	May 24, 2002	$3.75	17,333,333	65,000
Subscription receipts	July 9, 2002	$3.75	4,000,000	15,000
Total			36,679,653	$ 105,000

The net proceeds of the various equity issues along with funds from Cequel's bank facility were used to fund the acquisition of Chain Energy Corporation and the acquisition of the two major property acquisitions undertaken during the seventeen month period and for general corporate purposes.

In addition to the above noted equity issues, Cequel issued 3,000,000 common shares at a deemed price of $2.42 per common share to partially fund its acquisition of Chain Energy Corporation. Cequel also issued 7,619,047 common share purchase warrants on January 24, 2002 which allow the holder to purchase one common share of Cequel per warrant at a price of $1.25 per share for up to three years after the date of issue of the warrants. Also during the seventeen month period 1,654,000 stock options were exercised providing Cequel with an additional $712,000. The stock options exercised were substantially all held by the previous officers, directors and employees of Cequel who were replaced when the new management team and board of directors were put in place.

At December 31, 2002, Cequel had a $51,000,000 revolving demand loan facility with a major Canadian chartered bank. Currently the loan facility has scheduled quarterly reductions of $3,000,000 in the amount available to Cequel beginning April 1, 2003. However, Cequel's bank is currently reviewing Cequel's results along with the updated reserve report and we expect a significant increase in the amount available to Cequel under the loan facility as a result of this review.

On an ongoing basis Cequel will typically utilize three sources of funding to finance its capital expenditure program; internally generated cash flow from operations, debt where deemed appropriate and new equity issues if available on favorable terms. When financing corporate acquisitions, Cequel may also assume certain future liabilities. In addition, Cequel may adjust its capital expenditure program depending on the commodity price outlook. The current estimate of capital expenditures in 2003 of $50 – $60 million should be able to be funded primarily out of internally generated cash flow.

Risks and Uncertainties

Cequel is exposed to operational risks inherent in exploring for, developing and producing crude oil and natural gas. Cequel's operations may be delayed or unsuccessful for many reasons, including cost overruns, lower oil and natural gas prices, equipment shortages, mechanical and technical difficulties and labor problems. Drilling activities, in particular, are subject to many risks and uncertainties including unforeseen technical problems that could lead to blowouts and the risk that no commercially productive reservoirs will be encountered. In addition, there are numerous uncertainties in estimating oil and natural gas reserves and in projecting future production, costs and expenses and the results, timing and costs of exploration and development projects. The oil and natural gas industry is extremely competitive, and Cequel may not be able to complete successfully with some of its larger, well-established competitors. Any of these risks could result in the total quantity or timing of production to vary significantly from reserves and production estimates made by management or others.

An insurance program is maintained to mitigate risks and to protect against significant losses, while maintaining levels of risk within the Company which management believes to be acceptable. While Cequel believes that its liability, property and business interruption insurance is adequate and consistent with industry participants of Cequel's size, Cequel is unable to obtain insurance to cover all risks within the business or in amounts to cover all possible claims.

The prices of and demand for oil and natural gas fluctuate for reasons largely beyond Cequel's control. Both oil and natural gas prices are extremely volatile and very difficult to predict. Significant downward fluctuations in the price of oil and natural gas may have a significant negative impact on Cequel's revenue. Significant upward fluctuations in the price of oil and natural gas may increase the competition in the industry and restrict Cequel's ability to compete on a cost effective basis. Cequel will monitor and, when appropriate, may utilize derivative financial instruments and physical delivery contracts to hedge its exposure to commodity price fluctuation risks. However, there are many risks inherent in any commodity hedging program including counter-party risk, foregoing increases in price above the hedge price, margin calls, inability to provide for the required physical delivery of the commodity, paying royalties on a higher market or reference price and negative public market sentiment on an out-of-the-money hedging program.

Cequel's operations may be adversely affected by changes in governmental policies, regulations or taxation concerning the Canadian oil and natural gas industry. Changes in any of these areas may significantly increase Cequel's costs or adversely impact Cequel's ability to conduct business.

Cequel's operations are highly dependant upon its executive officers and key personnel. The unexpected loss of the services of any of these individuals could have an adverse impact on Cequel.

Outlook

The transactions undertaken in the seventeen month period ended December 31, 2002 have formed the base from which Cequel will grow over the next year and beyond. We are currently engaged in drilling and recompletion opportunities on the acquired properties. We have initiated an exploration program on the acquired properties and we expect these properties to provide numerous drilling opportunities over the coming year. In addition, we will continue to review property and corporate acquisitions where we believe such an acquisition could add to Cequel's profitable growth.

Impact of New Accounting Pronouncements

In November 2002, the Canadian Institute of Chartered Accountants ("CICA") amended its accounting guideline on hedging relationships, which was originally issued in November 2001. The guideline establishes certain conditions where hedge accounting may be applied. It is effective for years beginning on or after July 1, 2003. Cequel does not currently have any hedging programs in place therefore this guideline will not currently have any impact on Cequel's reporting. However, in the event that Cequel enters into hedging programs in the future this new guideline will be followed if applicable.

In December 2002, the CICA issued a new standard on the impairment of long-lived assets, which is effective for years beginning on or after April 1, 2003. The new standard requires an impairment loss for a long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition, which loss should be measured as the amount by which its carrying amount exceeds its fair value, and provides guidance on how to determine fair value. Cequel does not currently expect this guideline to have a material impact on the Company.

In December 2002, the CICA issued a new standard on the disposal of long-lived assets and discontinued operations, which is effective for disposal activities initiated by a company's commitment to a plan on or after May 1, 2003. The new standard requires an asset classified as held for sale to be measured at fair value less cost to sell, provides criteria for classifying assets as held for sale and classifying a disposal as discontinued operations, and specifies presentation and disclosures for discontinued operations and other disposals of long-lived assets. Cequel does not current expect this guideline to have a material impact on the Company.

Quarterly Financial Information

The following is a summary of selected quarterly information that has been derived from the unaudited financial statements of Cequel. The quarterly information provided for the period ended December 31, 2002 is for a seventeen month period having six quarters. The quarter ended June 30, 2002 is for a two month period whereas all other quarters represent three month periods. The summary should be read together with the unaudited financial statements of Cequel as contained in the public record.

QUARTERLY INFORMATION — TABLE K

($000, except per share amounts)	December 31 2002 Q6	September 30 2002 Q5	June 30 2002 Q4	April 30 2002 Q3
Oil and Natural Gas Sales	25,385	14,542	4,067	4,376
Cash Flow from Operations	16,025	7,813	2,038	1,710
per share – basic	0.278	0.142	0.055	0.051
– diluted	0.248	0.126	0.047	0.043
Net Earnings (Loss)	5,905	884	432	(185)
per share – basic	0.102	0.016	0.012	(0.006)
– diluted	0.091	0.014	0.010	(0.006)

QUARTERLY INFORMATION — TABLE L

($000, except per share amounts)	January 31 2002 Q2	October 31 2001 Q1	July 31 2001 Q4	April 30 2001 Q3
Oil and Natural Gas Sales	3,195	4,099	5,120	6,399
Cash Flow from Operations	(2,450)	1,853	4,059	2,189
per share – basic	(0.143)	0.112	0.245	0.132
– diluted	(0.143)	0.104	0.226	0.122
Net Earnings (Loss)	(2,311)	495	64	2,826
per share – basic	(0.135)	0.030	0.004	0.170
– diluted	(0.135)	0.028	0.004	0.155

Management's Report

» Management, in accordance with Canadian generally accepted accounting principles, has prepared the accompanying financial statements of Cequel Energy Inc. Financial and operating information presented throughout this Annual Report is consistent with that shown in the financial statements.

Management is responsible for the integrity of the financial information. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

Deloitte & Touche LLP, were appointed by the Company's shareholders to perform an examination of the corporate and accounting records so as to express an opinion on the financial statements. Their examination included a review and evaluation of Cequel's internal control systems and included such tests and procedures, as they considered necessary, to provide reasonable assurance that the financial statements are presented fairly in accordance with Canadian generally accepted accounting principles.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility with the assistance of the Audit Committee. The Committee meets with management and the independent auditors to ensure that management's responsibilities are properly discharged, to review the financial statements and recommend that the financial statements be presented to the Board of Directors for approval.

Donald F. Archibald
President and Chief Executive Officer
February 28, 2003

Randal Brockway
Vice President, Finance and Chief Financial Officer

Auditors' Report

TO THE SHAREHOLDERS OF CEQUEL ENERGY INC.:

We have audited the balance sheet of Cequel Energy Inc. as at December 31, 2002 and the statement of earning and retained earnings and cash flows for the seventeen month period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and the results of its operations and its cash flows for the seventeen month period ended December 31, 2002 in accordance with Canadian generally accepted accounting principles.

The financial statements as at July 31, 2001 and for the year then ended, were reported on by another firm of Chartered Accountants who expressed an unqualified opinion on those financial statements dated October 29, 2001.

Deloitte & Touche LLP

Chartered Accountants
Calgary, Alberta February 28, 2003

Balance Sheets

(thousands of dollars)	notes	December 31 2002	July 31 2001
ASSETS			
Current assets			
Cash		759	–
Accounts receivable		14,663	2,797
Deposits, prepaids and other		1,340	198
		16,762	2,995
Property and equipment	5	187,749	24,245
		204,511	27,240
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Operating overdraft		–	1,023
Accounts payable and accrued liabilities		24,879	5,836
Income taxes payable		51	685
Revolving demand loan	6	37,000	–
		61,930	7,544
Long-term debt		–	3,100
Future income taxes	9	13,537	3,843
Provision for future site restoration		1,254	109
		76,721	14,596
SHAREHOLDERS' EQUITY			
Share capital	7	113,030	2,959
Retained earnings		14,760	9,685
		127,790	12,644
		204,511	27,240

See accompanying notes

On behalf of the board:

Douglas A. Dafoe
Director

Fred C. Coles
Director

Statements of Income and Retained Earnings

(thousands of dollars, except per share amounts)	notes	December 31 2002 (17 Months)	July 31 2001 (12 Months)
REVENUE			
Petroleum and natural gas sales		55,664	26,885
Royalties, net of ARTC		(11,922)	(5,897)
		43,742	20,988
Other income		218	6
		43,960	20,994
EXPENSES			
Production		9,317	3,851
General and administrative		3,981	3,382
Reorganization	3	2,645	–
Interest		1,128	494
Depletion, depreciation and site restoration	5	17,226	4,604
		34,297	12,331
Earnings from operations		9,663	8,663
Gain on sale of investments		–	2,153
Earnings before taxes		9,663	10,816
Taxes	9		
Income and capital taxes (recoveries)		(99)	685
Future income taxes		4,542	2,815
Net earnings for the period		5,220	7,316
Retained earnings, beginning of period, as previously reported		9,907	2,591
Adjustment for acquisition of shares in excess of carrying value	7	(222)	–
Retained earnings, beginning of period, as adjusted		9,685	2,591
Acquisition of shares in excess of carrying value		(145)	(222)
Retained earnings, end of period		14,760	9,685
NET EARNINGS PER SHARE	8		
Basic		0.14	0.44
Diluted		0.13	0.41

See accompanying notes

Statements of Cash Flows

(thousands of dollars, except per share amounts)	notes	December 31 2002 (17 Months)	July 31 2001 (12 Months)
CASH PROVIDED BY (USED IN):			
OPERATING ACTIVITIES			
Net earnings for the period		5,220	7,316
Items not affecting cash			
Depletion, depreciation and site restoration		17,226	4,604
Future income taxes		4,542	2,815
Gain on sale of investments		–	(2,153)
Cash flow from operations		26,988	12,582
Net changes in non-cash working capital		(3,241)	(2,249)
		23,747	10,333
FINANCING ACTIVITIES			
Issue of common shares and subscription receipts		105,000	–
Issue of common shares on exercise of stock options		712	7
Repurchase of common shares		(172)	(244)
Share issue costs		(4,975)	–
Increase (decrease) in revolving demand loan		24,729	(1,100)
		125,294	(1,337)
INVESTING ACTIVITIES			
Corporate acquisition	4	(35,566)	–
Items not affecting cash			
Common shares issued on acquisition		7,260	–
Assumption of bank debt		9,171	–
Assumption of working capital surplus		(1,253)	–
Cash consideration		(20,388)	–
Additions to property and equipment		(136,669)	(15,154)
Site restoration and abandonment expenditures		(96)	
Sale of marketable securities		–	5,921
Change in non-cash working capital items		9,894	(755)
		(147,259)	(9,988)
Increase (decrease) in cash		1,782	(992)
Cash (overdraft), beginning of period		(1,023)	(31)
CASH (OVERDRAFT), END OF PERIOD		759	(1,023)
CASH FLOW FROM OPERATIONS PER SHARE	8		
Basic		0.75	0.76
Diluted		0.66	0.70

See accompanying notes

Notes to the Financial Statements

Periods Ended December 31, 2002 and July 31, 2001

(All tabular amounts in thousands, except for per share amounts and number of shares)

NOTE 1 CHANGE IN FISCAL PERIOD AND COMPANY NAME

On July 4, 2002, the Company filed a notice under National Policy Statement No. 51 stating the Company's intention to change the ending date of its financial year to December 31 from July 31, with the next year-end occurring December 31, 2002. This has resulted in the Company having a fiscal period ending December 31, 2002 that consists of seventeen months. The Company's fiscal period in 2003 will consist of a twelve month period ending on December 31.

On April 9, 2002, the name of the Company was changed from Argonauts Group Ltd. to Cequel Energy Inc.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Cequel Energy Inc. ("Cequel" or the "Company") have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the accounting policies summarized below:

Revenue Recognition

Revenues associated with sales of petroleum and natural gas and all other items are recorded when title passes to the customer.

Inventory

Inventory of materials and equipment is carried at the lower of cost and net realizable value and is included in deposits, prepaids and others.

Property and Equipment

Capitalized costs

The Company follows the full cost method of accounting whereby all costs relating to the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in one Canadian cost centre and are charged against income, as set out below. Such costs include land and lease acquisitions, geological and geophysical expenditures, drilling of productive and non-productive wells, production and gathering equipment and facilities, carrying costs directly related to unproved properties and corporate expenses directly related to acquisition, exploration and development activities. Proceeds from the disposition of petroleum and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized unless such disposition results in a change of 20 percent or more in the depletion and depreciation rate.

Depletion and depreciation

Depletion and depreciation of petroleum and natural gas properties are calculated using a unit of production method based on estimated gross proved petroleum and natural gas reserves, as determined by independent engineers. For purposes of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of six thousand cubic feet of natural gas equates to one barrel of oil. In determining its depletion base, the Company includes estimated future costs to be incurred in developing proven reserves and excludes estimated salvage values and the cost of unproved properties. Costs of acquiring and evaluating unproved properties are excluded from the depletion base until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Depreciation on other equipment is provided over its useful lives using the straight line and declining balance methods at rates varying from 20 to 30%.

Ceiling test

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the "ceiling test"). Under this test, an estimate is made of the ultimate recoverable amount from future net revenues using proved reserves and period end prices, less future removal

and site restoration costs, overhead, financing costs and income taxes. If the net carrying costs exceed the ultimate recoverable amount, additional depletion and depreciation is provided in the amount of the excess.

Future Site Restoration and Abandonment Costs

Estimates are made of the future site restoration and abandonment costs relating to the Company's petroleum and natural gas properties at the end of their economic life. This estimate includes the cost of equipment removal and environmental clean up in accordance with current legislative requirements and industry practice based on current cost estimates. Annual charges are provided for on a unit of production method. Actual site restoration costs are deducted from the provision for future site restoration costs in the year incurred. The 2002 provision of $481,000 (2001 – $29,000) is included in depletion, depreciation and site restoration expense.

Joint Interests

A portion of the Company's exploration, development and production activities is conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Measurement Uncertainty

The amounts recorded for depreciation, depletion and amortization of petroleum and natural gas property and equipment and for site restoration and reclamation are based on estimates of petroleum and natural gas reserves and future costs. By their nature, these estimates are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material.

Flow Through Shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Share capital is reduced and future income tax is increased by the income tax amount related to the renounced deductions.

Stock Based Compensation

The Company has a stock-based compensation plan, which is described in Note 7. No compensation expense is recognized for these plans when stock options are issued at the prevailing market prices. Any consideration paid by employees or directors on the exercise of these stock options is recorded as share capital. For options issued after January 1, 2002, the fair values are determined and the impact on earnings is disclosed as pro forma information in Note 7.

Future Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax is based on the differences between assets and liabilities reported for financial accounting purposes and those reported for income tax purposes. Future income taxes are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change occurs.

Per Share Amounts

Basic earnings per share and basic cash flow from operations per share are computed by dividing earnings and cash flow from operations by the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if options or warrants to purchase common shares were exercised. The treasury stock method is used to determine the dilutive effect of stock options and warrants, whereby any proceeds from the exercise of stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

NOTE 3 REORGANIZATION

On January 24, 2002, the Company completed an $8.0 million private placement of common shares and warrants and certain reorganization transactions which included the resignation of all the then current directors and officers of the Company and the appointment of new officers and a new board of directors. The costs of the reorganization, which consist primarily of severance payments to the previous officers and directors of the Company, have been expensed in the seventeen month period ending December 31, 2002 as reorganization expenses.

NOTE 4 CORPORATE ACQUISITION

Effective March 31, 2002, the Company acquired all of the issued and outstanding shares of Chain Energy Corporation ("Chain"), a public company involved in the exploration, development and production of oil and natural gas in Western Canada. The acquisition has been accounted for by the purchase method of accounting as follows:

CONSIDERATION		
Cash	$	19,992
Transaction costs		396
		20,388
Issue of 3,000,000 common shares		7,260
	$	27,648

NET ASSETS ACQUIRED		
Property and equipment	$	43,579
Future income taxes		(7,252)
Future site restoration costs		(761)
		35,566
Working capital surplus		1,253
Bank debt		(9,171)
	$	27,648

On March 31, 2002, the Company and Chain were amalgamated pursuant to the Business Corporations Act (Alberta).

NOTE 5 PROPERTY AND EQUIPMENT

		December 31 2002		July 31 2001
Petroleum and natural gas properties and equipment	$	210,339	$	30,450
Other		592		231
		210,931		30,681
Accumulated depletion and depreciation		(23,182)		(6,436)
Net book value	$	187,749	$	24,245

On June 27, 2002, Cequel closed the acquisition of certain producing oil and gas properties located in Alberta for a purchase price of approximately $75,800,000, subject to price adjustments effective June 1, 2002.

On August 28, 2002, Cequel closed the acquisition of certain producing oil and gas properties located in Alberta for a purchase price of approximately $32,500,000, subject to price adjustments effective July 1, 2002.

During the 2002 fiscal period, $ nil (2001 – $0.2 million) general and administrative expenses relating to exploration and development expenses were capitalized. In calculating the depletion provision for 2002, $13.9 million (2001 – $3.4 million) of costs relating to undeveloped properties were excluded from costs subject to depletion.

The Company performed a ceiling test as at December 31, 2002 using year end field prices of $40.94 per barrel of oil, $36.98 per barrel of ngl and $6.22 per mcf of natural gas. Based on the results of this test the Company was not required to take a ceiling test write down at December 31, 2002.

At December 31, 2002, the estimated future site restoration costs to be accrued over the life of the remaining proved reserves are $7.1 million (2001 – $0.3 million).

REVOLVING DEMAND LOAN

NOTE 6

The bank loan consists of a demand revolving operating credit facility provided by a Canadian chartered bank. At December 31, 2002 the credit facility is limited to $51 million, and provides for quarterly reductions in the amount available under the facility of $3 million commencing on April 1, 2003. The credit facility provides that advances may be made by way of direct advances or bankers' acceptances. Direct advances bear interest at the bank's prime lending rate plus a variable rate and bankers' acceptances bear interest at the applicable bankers' acceptances rate plus a variable rate per annum stamping fee. The variable rate charged by the bank is dependant upon the Company's debt to trailing cash flow ratio. Currently, the variable rate being charged to the Company is nil for prime loans and 1% for the variable rate on the stamping fees for bankers' acceptances. The credit facility is subject to periodic review and is secured by a $100 million demand fixed and floating charge debenture over all the Company's assets.

Effective January 1, 2002, the Company classified its bank loan as current in accordance with new guidance issued by the Canadian Institute of Chartered Accountants Emerging Issues Committee. The new guidance relates to the presentation of debt obligations that, by their terms, are due and callable within one year from the balance sheet date, even though payment may not be expected within that period. Under the new guidance, debt obligations are classified based on facts existing at the balance sheet date rather than on expectations regarding future financing or renegotiation.

SHARE CAPITAL

NOTE 7

Authorized

At December 31, 2002 the Company had authorized an unlimited number of common shares and an unlimited number of preferred shares.

Issued

COMMON SHARES

	December 31, 2002		July 31, 2001	
	# Shares	Amount	# Shares	Amount
Balance, beginning of period	16,542,199	$ 2,937	16,616,999	$ 2,952
Repurchase of common shares	(150,000)	(27)	(124,800)	(22)
Exercise of stock options	1,654,000	712	50,000	7
Issued on private placements	15,346,320	25,000	–	–
Issued on corporate acquisition (note 4)	3,000,000	7,260	–	–
Issued on conversion of subscription receipts	21,333,333	77,787	–	–
Share issue costs, net of future taxes		(661)	–	–
Balance, end of period	57,725,852	$ 113,008	16,542,199	$ 2,937

Private Placements

On January 24, 2002, the Company closed a private placement in conjunction with certain reorganization transactions whereby the Company issued 7,619,047 common shares for $1.05 per common share for gross proceeds of $8.0 million.

On February 12, 2002, the Company closed a bought deal private placement whereby the Company issued 7,727,273 common shares for $2.20 per common share for gross proceeds of $17.0 million.

SUBSCRIPTION RECEIPTS

	December 31, 2002		July 31, 2001	
	# Receipts	Amount	# Receipts	Amount
Balance, beginning of period	–	$ –	–	$ –
Issued on private placement	21,333,333	80,000	–	–
Issue costs, net of future taxes	–	(2,213)	–	–
Converted into common shares	(21,333,333)	(77,787)	–	–
Balance, end of period	–	$ –	–	$ –

On May 24, 2002, the Company issued 17,333,333 subscription receipts, at a price of $3.75 per subscription receipt, pursuant to a bought deal private placement for aggregate gross proceeds of $65.0 million. Each subscription receipt entitled the holder to receive, on exercise or deemed exercise thereof, one common share for no additional consideration. The proceeds of the issue were placed in escrow and were released to the Company on June 27, 2002 upon the closing of a certain property acquisition. All of the subscription receipts were converted, or deemed to have been converted, into common shares by July 5, 2002.

On July 9, 2002, the Company issued 4,000,000 subscription receipts, at a price of $3.75 per subscription receipt, for aggregate gross proceeds of $15.0 million. Each subscription receipt entitled the holder to receive, on exercise or deemed exercise thereof, one common share for no additional consideration. The proceeds of the issue were placed in escrow and were released to the Company on August 28, 2002, upon the closing of a certain property acquisition. All of the subscription receipts were converted, or deemed to have been converted, into common shares by September 5, 2002.

SPECIAL WARRANTS

	Number of Special Warrants	Amount
Balance – July 31, 2001 and December 31, 2002	22,500	$ 22

The Special warrants may be converted into common shares with no additional consideration.

WARRANTS

	Number of Warrants	Amount
Balance – July 31, 2001	–	$ –
Issued on private placement	7,619,047	–
Balance – December 31, 2002	7,619,047	–

On January 24, 2002 the Company issued 7,619,047 warrants in conjunction with a private placement of its common shares. Each warrant is exercisable into one common share of the Company at any time commencing January 24, 2003 and ending January 24, 2005 at an exercise price of $1.25 per share. A nominal value has been ascribed to the warrants for accounting purposes.

Stock Options

The Company has a stock option plan (the "Plan") for the benefit of its employees and directors. Options under the Plan vest over a four year period with 20 percent of the options vesting immediately upon grant and a further 20 percent vesting upon each anniversary date of the grant. The options expire, if unexercised, five years from the date of the initial grant. As of December 31, 2002, there were 3,334,850 common shares reserved for future issuance under the plan. Total stock option activity related to the Plan was as follows:

	December 31, 2002		July 31, 2001	
	Number of Options	Weighted Average Price	Number of Options	Weighted Average Price
Balance, beginning of period	1,575,000	$ 0.37	1,500,000	$ 0.24
Granted	2,639,000	2.04	125,000	1.83
Exercised	(1,654,000)	0.43	(50,000)	0.15
Cancelled	(5,000)	1.20	–	–
Balance, end of period	2,555,000	$ 2.05	1,575,000	$ 0.37

The following table summarizes information about the stock options outstanding as at December 31, 2002:

	Options Outstanding			Exercisable Options	
	Number Outstanding	Weighted Average Remaining Term (years)	Weighted Average Excercise Price	Number Exercisable	Weighted Average Excercise Price
$ 1.20	1,766,000	4.1	$ 1.20	350,000	$ 1.20
$ 3.00 to 3.99	499,000	4.5	$ 3.66	99,800	$ 3.66
$ 4.00 to 4.99	290,000	4.9	$ 4.44	58,000	$ 4.44
Total	2,555,000	4.3	$ 2.05	507,800	$ 2.05

Normal Course Issuer Bid

In December 2000, the Company announced its intention to make a Normal Course Issuer Bid through the facilities of the Canadian Venture Exchange to purchase up to 830,000 common shares of the Company during the twelve month period beginning December 8, 2000 and ending December 7, 2001. For the seventeen month period ended December 31, 2002 the Company had purchased 150,000 common shares for total cash consideration of $172,000. As the consideration paid was in excess of the stated value of the shares, the amount in excess totaling $145,000 was charged to retained earnings.

For the year ended July 31, 2001, the Company purchased 124,800 common shares through its Normal Course Issuer Bid for a total cash consideration of $244,000. The consideration paid was in excess of the stated value of the shares by a total of $222,000, accordingly, the Company has restated its share capital and retained earnings for the year ended July 31, 2001 in order to charge the excess amount to retained earnings.

Stock Based Compensation

The Company accounts for its stock based compensation plan using intrinsic values. Under this method, no costs are recognized in the financial statements for share options granted to employees or directors when the options are issued at prevailing market prices. For fiscal years beginning on or after January 1, 2002, Canadian generally accepted accounting principles require disclosure of the impact on net earnings using the fair market value method for stock options issued on or after January 1, 2002. If the fair value method had been used, the Company's net earnings and net earnings per share for the seventeen month period ended December 31, 2002 would approximate the following pro forma amounts:

	Seventeen Months Ended December 31, 2002
Net Earnings:	
As reported	$ 5,220
Pro forma	$ 4,489
Net Earnings per Share:	
Basic	
As reported	$ 0.14
Pro forma	$ 0.12
Diluted	
As reported	$ 0.13
Pro forma	$ 0.11

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

	Seventeen Months Ended December 31, 2002
Risk free interest rate (%)	4.6
Expected life (years)	4.5
Expected volatility (%)	50

The weighted average fair market value of stock options granted in the seventeen month period ended December 31, 2002 was $0.95 per option.

NOTE 8

PER SHARE AMOUNTS

	December 31 2002	July 31 2001
Basic		
Earnings per share	$ 0.14	$ 0.44
Cash flow from operations per share	$ 0.75	$ 0.76
Weighted average number of shares outstanding	36,159,864	16,587,250
Diluted		
Earnings per share	$ 0.13	$ 0.41
Cash flow from operations per share	$ 0.66	$ 0.70
Weighted average number of shares outstanding	40,623,702	17,862,963

The number of shares used in the calculation of diluted net earnings and cash flow from operations per share for the period ended December 31, 2002 was 40.6 million (July 31, 2001 – 18.0 million) shares. This figure included the weighted average number of shares outstanding of 36.2 million (July 31, 2001 – 16.6 million) plus 1.2 million (July 31, 2001 – 1.2 million) shares related to dilutive effect of stock options plus 3.2 million (July 31, 2001 – 0.1 million) shares related to the dilutive effect of warrants.

The weighted average number of shares used in the diluted earnings and cash flow from operations per share calculation as discussed above did not include 140,702 (July 31, 2002 – nil) weighted average number of stock options due to their anti-dilutive effect.

NOTE 9

INCOME TAXES

The provision for income taxes has been computed as follows:

Periods ended	December 31 2002	July 31 2001
Earnings before taxes	$ 9,663	$ 10,816
Expected income taxes at the statutory rate of 42.12% (July 31, 2001 – 43.4%)	$ 4,070	$ 4,691
Increase (decrease) in taxes resulting from:		
Non-deductible crown payments, net of ARTC	3,742	983
Resource allowance	(3,393)	(1,758)
Income tax rate change	(180)	(29)
Non-taxable portion of gain on sale of marketable securities	–	(471)
Non-capital losses carried-back to previous years	389	–
Non-deductible payments	112	72
Provincial rebates	(221)	–
Recovery of previous years' income taxes	(408)	–
Large corporations tax and provincial capital taxes	309	–
Other	23	12
Provision for income taxes	$ 4,443	$ 3,500
Current income taxes (recoveries)	$ (408)	$ 685
Large corporations tax and provincial capital taxes	309	–
Future income taxes	4,542	2,815
	$ 4,443	$ 3,500

The components of future income taxes are as follows:

Periods ended	December 31 2002	July 31 2001
Future income tax liabilities:		
Property and equipment in excess of tax values	$ 16,863	$ 3,890
Future income tax assets:		
Future site restoration	(528)	(47)
Other	(2,798)	–
Future income taxes	$ 13,537	$ 3,843

At December 31, 2002, the Company has tax pools of approximately $152.0 million (July 31, 2001 – $15.3 million) available for deduction against future taxable income.

FINANCIAL INSTRUMENTS

NOTE 10

Fair Values

The Company's financial instruments included in the balance sheets are comprised of accounts receivable and current liabilities, including the revolving demand loan. The fair values of these financial instruments approximate their carrying value due to the short-term maturity of those instruments. Borrowings under bank credit facilities are for short periods and are market based, thus, carrying values approximate fair value.

Risk Management Activities

The nature of the Company's operations result in exposure to fluctuations in commodity prices, exchange rates and interest rates. The Company monitors and when appropriate, may use derivative financial instruments to manage its exposure to these risks. The Company is also subject to credit risk on its accounts receivable.

RELATED PARTY TRANSACTIONS

NOTE 11

During the seventeen month period ended December 31, 2002, the Company paid $ nil (July 31, 2001 – $36,000) of directors fees to former directors and $308,000 (July 31, 2001 – $1,991,000) of consulting fees to corporations controlled by former officers of the Company.

During the seventeen month period the Company sold certain of its minor properties pursuant to a competitive bid process. One of these transactions resulted in the sale of certain producing oil and natural gas properties to a public corporation whose President is also a director of the Company. The transaction was recorded at the exchange amount of $910,000 (July 31, 2001 – $ nil) and was supported by other independent bids for the properties.

The Company paid $53,000 (July 31, 2001 – $26,000) in legal fees to a firm in which a former director and officer of the Company is a partner. The Company paid $674,000 (July 31, 2001 – $ nil) in legal fees to a firm in which the Company's Corporate Secretary is also a partner.

Included in accounts receivable at December 31, 2002 was $ nil (July 31, 2001 – $187,000) advanced to a former officer and director of the Company.

NOTE 12 SUPPLEMENTAL CASH FLOW INFORMATION

Increase (Decrease) in Non-Cash Working Capital Items	December 31 2002	July 31 2001
Accounts receivable	$ (7,514)	$ 2,172
Deposits, prepaids and other	(815)	(173)
Accounts payable and accrued liabilities	15,616	(4,471)
Income taxes payable	(634)	(532)
Change in non-cash working capital	$ 6,653	$ (3,004)
Changes in non-cash working capital related to:		
Operating activities	$ (3,241)	$ (2,249)
Investing activities	9,894	(755)
	$ 6,653	$ (3,004)

During the seventeen month period ended December 31, 2002 and the twelve month period ended July 31, 2001 the Company made the following cash outlays in respect of interest expense and current income taxes.

Periods ended	December 31 2002	July 31 2001
Interest	$ 1,091	$ 537
Current income taxes	$ 950	$ 1,217

NOTE 13 COMMITMENTS

The Company is committed to payments under various operating leases for office space as follows:

Year	Amount
2003	$ 262
2004	277
2005	291
2006	305
2007	237

In addition, the Company is required to pay its share of operating expenses, utilities, and taxes, for the duration of the office lease.

The Company is also committed to minimum payments under an operating lease for a certain natural gas pipeline as follows:

Year	Amount
2003	$ 374
2004	374
2005	343

Either party to the natural gas pipeline lease may terminate the lease at any time by giving one years notice of such termination. If no notice of termination is given at December 1, 2005 by either party the lease is automatically extended until the date that is one year from the date written notice is given by one party to the other. The minimum lease payments are adjusted annually for inflation. In addition to the minimum lease payments, the Company is responsible for all operating expenses and required capital expenditures on the pipeline during the term of the lease.

NOTE 14 CONTINGENCIES

The Company is party to various legal claims associated with the ordinary conduct of business. The Company believes it has made adequate provision in its financial statements for such legal claims.

NOTE 15 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current period's presentation.

Corporate Information

Officers

Donald F. Archibald
President
and Chief Executive Officer

Randal Brockway
Vice President, Finance
and Chief Financial Officer

Howard Crone
Vice President, Operations
and Chief Operating Officer

Alison Jones
Vice President, Exploration

Gary Peddle
Vice President, Land

Directors

Donald F. Archibald
President and Chief Executive Officer
Cequel Energy Inc.

Fred C. Coles
President and Chief Executive Officer
Menehune Resources Ltd.

Douglas A. Dafoe
President and Chief Executive Officer
Thunder Energy Inc.

Max Muselius
Independent Businessman

Geoffrey A. Cumming
Vice Chairman and Chief Executive Officer
Gardiner Group Capital Limited

Bankers

Bank of Montreal
Calgary, Alberta

Auditors

Deloitte & Touche LLP
Calgary, Alberta

Evaluation Engineers

Gilbert Lausten Jung Associates Ltd.
Calgary, Alberta

Legal Counsel

Macleod Dixon
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Calgary, Alberta

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Stock Listing Symbol:

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The Toronto Stock Exchange

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Printed in Canada

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